

# FDIC State Profile

Spring 2005

## Minnesota

Minnesota's employment showed continued strength in the fourth quarter of 2004.

- Minnesota's economy continued to strengthen in the fourth quarter, adding jobs in four consecutive quarters for the first time since the first quarter of 2001. Total employment increased by 35,800 jobs in 2004, the largest annual increase since 2000 (See Chart 1).
- The manufacturing sector gained strength, adding 4,100 jobs in the fourth quarter and contributing to an annual increase of 6,800 jobs.
- Unemployment declined to 4.5 percent in the fourth quarter, matching the second quarter number, the lowest experienced since the fourth quarter of 2002.

### Banking performance remains solid.

- Asset quality, which suffered only modestly through Minnesota's 2001-03 economic downturn, continues to improve (See Table 1). Loan activity surged in 2004; after remaining slightly above 65 percent the last four years, the median loan-to-asset ratio jumped from 65.9 percent to 69.1 percent.
- Loan mix continues shifting into real estate lending, specifically commercial real estate (CRE) and farmland. The median CRE loan-to-asset ratio has increased sharply over the past five years, from 16.2 percent in 2000 to 25.3 percent in 2004. Business and residential lending has been steady, and agriculture production and consumer lending have declined.
- The proportion of unprofitable, established institutions in Minnesota was 2.6 percent, similar to ratios in the preceding four years.<sup>1</sup>

### The Minneapolis office market improved in the fourth quarter of 2004.

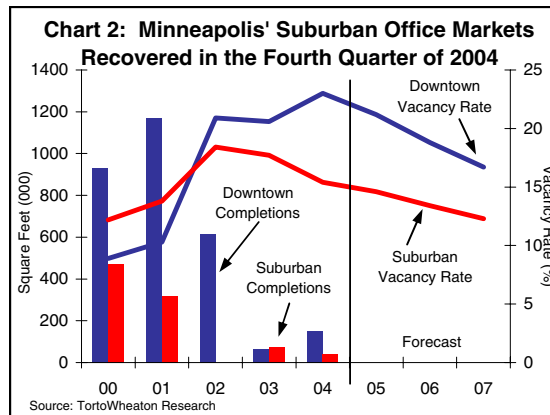
- Vacancy rates in the Minneapolis office market declined for the third straight quarter to 19 percent in the fourth quarter of 2004, down from a peak of 20 percent in the first quarter of 2004.



**Table 1: Asset Quality and Earnings Continue to Improve at Minnesota's Insured Institutions**

	12-04	12-03	12-02	12-01	12-00
<b>Capital</b>					
Tier 1 Leverage Capital	9.2	9.0	8.9	8.8	8.9
<b>Asset Quality</b>					
Past Due Loan Ratio	1.38	1.65	1.85	2.01	1.81
Net Charge-off Rate	0.07	0.10	0.11	0.11	0.06
<b>Earnings</b>					
Pretax Return on Assets	1.57	1.53	1.62	1.52	1.62
Net Interest Margin	4.37	4.33	4.50	4.39	4.48

Source: FDIC. Figures are median percent values.



<sup>1</sup>Established institutions are insured institutions that have been in operation for at least three years.

## State Profile

- Suburban markets saw the greatest decline in vacancy rates for the metro from 16.2 percent in the third quarter to 15.4 percent in the fourth quarter of 2004. While vacancy rates also declined for the downtown market, excess supply from previous quarters of overbuilding kept vacancy rates high throughout 2004 at 23 percent (See Chart 2).
- Positive job growth in office-using employment and minimal new construction are expected to lower vacancy rates in 2005 to around 17 percent.

### Commercial banks are likely to face pressure to raise nonmaturity deposit rates.

- In relatively stable interest rate environments, the cost of bank nonmaturity deposits typically run at about half of the Federal funds rate. When short-term rates tumbled in 2001 and 2002, however, deposit rates failed to completely follow, indicating that nonmaturity deposit rates had reached a natural floor (See Chart 3).
- Should interest rates continue to rise, banks will likely feel increasing pressure from customers to raise deposit rates.

### Minnesota's farmland values increased significantly in 2004.

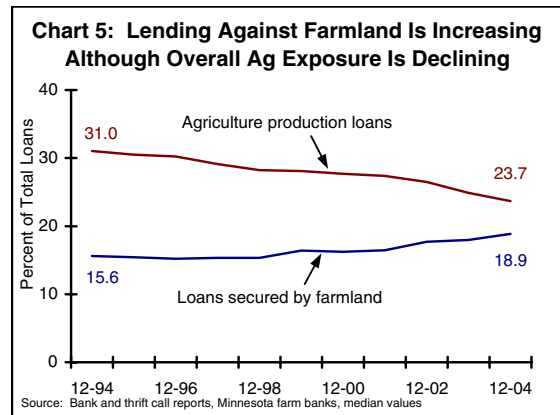
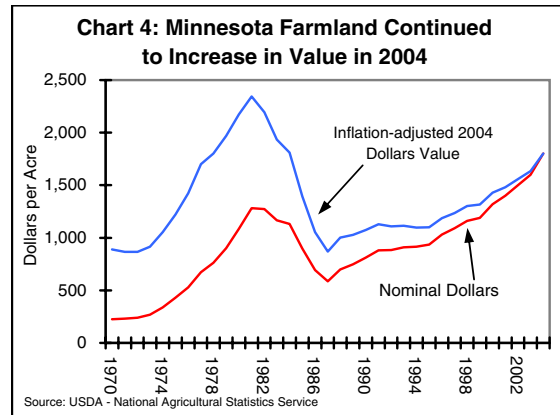
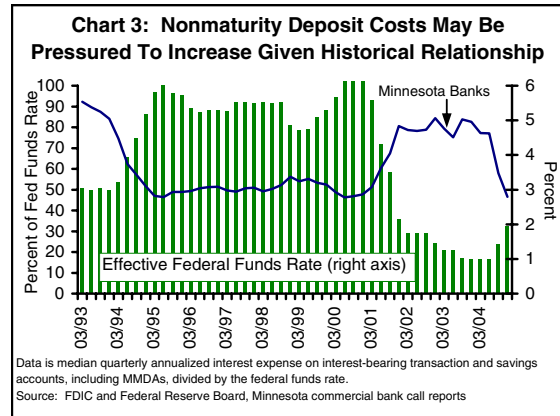
- According to the United States Department of Agriculture's annual survey of land values, the average value of Minnesota farmland increased more than 12.5 percent in 2004, compared with an annual average of 5.8 percent over the previous decade (See Chart 4).
- While the average price of \$1,800 per acre was the highest recorded in current dollars, farmland prices in the 1980s were considerably higher in inflation-adjusted dollars. In 1981, for example, Minnesota's average land prices exceeded \$2,345 in 2004 dollars.
- Survey respondents listed low interest rates, favorable crop yields, and investment demand as the most important influences on increasing land prices.

### Farm banks are concentrating agricultural lending on farmland.

- Over the past decade, farm banks have taken steps to diversify their loan portfolios, which tend to be heavy with agriculture production loans. Such loans declined from 31.0 percent of total loans to 23.7 percent between year-end 1994 and 2004 (See Chart 5).
- Despite the overall decline in farm operating loans, reliance on farmland-secured loans increased 21 percent during that period, with much of the increase coming in recent years. The increase in farmland lending is

attributable to increased demand for farmland for both agricultural and nonagricultural uses, coupled with the stimulus of historically low interest rates.

- With nearly 20 percent of farm bank loan volume secured by farmland, its price stability becomes more important. Any unexpected shocks to farmland values, such as swift increases in interest rates, significant cuts in federal farm payments, or decreased demand for farmland used for urban expansion or recreational purposes, could have adverse effects on producers and agricultural lenders.



## Minnesota at a Glance

**ECONOMIC INDICATORS** (Change from year ago quarter, unless noted)

<b>Employment Growth Rates</b>	<b>Q4-04</b>	<b>Q4-03</b>	<b>Q4-02</b>	<b>Q4-01</b>	<b>Q4-00</b>
Total Nonfarm (share of trailing four quarter employment in parentheses)	1.2%	-0.3%	-0.3%	-1.0%	2.0%
Manufacturing (13%)	1.8%	-2.8%	-4.4%	-7.3%	0.3%
Other (non-manufacturing) Goods-Producing (5%)	0.6%	1.1%	0.0%	2.8%	4.7%
Private Service-Producing (67%)	1.4%	0.3%	0.2%	-0.3%	2.1%
Government (15%)	0.1%	-1.1%	1.1%	0.8%	2.1%
Unemployment Rate (% of labor force)	4.5	4.9	4.4	4.3	3.4

<b>Other Indicators</b>	<b>Q4-04</b>	<b>Q4-03</b>	<b>Q4-02</b>	<b>Q4-01</b>	<b>Q4-00</b>
Personal Income	N/A	3.8%	2.4%	1.7%	6.8%
Single-Family Home Permits	-5.4%	16.2%	6.8%	18.5%	-13.5%
Multifamily Building Permits	-2.8%	4.1%	4.8%	17.3%	39.3%
Existing Home Sales	2.9%	8.4%	13.7%	17.0%	5.0%
Home Price Index	8.1%	8.9%	8.8%	10.1%	10.6%
Bankruptcy Filings per 1000 people (quarterly level)	0.86	0.96	0.87	0.91	0.74

**BANKING TRENDS**

<b>General Information</b>	<b>Q4-04</b>	<b>Q4-03</b>	<b>Q4-02</b>	<b>Q4-01</b>	<b>Q4-00</b>
Institutions (#)	478	486	487	504	513
Total Assets (in millions)	63,483	108,679	111,175	110,453	189,967
New Institutions (# < 3 years)	15	13	14	19	20
Subchapter S Institutions	290	269	246	221	199

<b>Asset Quality</b>	<b>Q4-04</b>	<b>Q4-03</b>	<b>Q4-02</b>	<b>Q4-01</b>	<b>Q4-00</b>
Past-Due and Nonaccrual Loans / Total Loans (median %)	1.38	1.65	1.85	2.01	1.81
ALLL/Total Loans (median %)	1.25	1.27	1.27	1.26	1.25
ALLL/Noncurrent Loans (median multiple)	2.06	1.83	1.66	1.69	2.26
Net Loan Losses / Total Loans (median %)	0.07	0.10	0.12	0.11	0.06

<b>Capital / Earnings</b>	<b>Q4-04</b>	<b>Q4-03</b>	<b>Q4-02</b>	<b>Q4-01</b>	<b>Q4-00</b>
Tier 1 Leverage (median %)	9.21	9.05	8.92	8.81	8.91
Return on Assets (median %)	1.33	1.24	1.26	1.14	1.14
Pretax Return on Assets (median %)	1.57	1.54	1.63	1.51	1.62
Net Interest Margin (median %)	4.39	4.34	4.51	4.40	4.50
Yield on Earning Assets (median %)	5.91	6.13	6.89	8.02	8.49
Cost of Funding Earning Assets (median %)	1.49	1.76	2.40	3.64	3.97
Provisions to Avg. Assets (median %)	0.12	0.14	0.16	0.14	0.12
Noninterest Income to Avg. Assets (median %)	0.61	0.64	0.63	0.63	0.61
Overhead to Avg. Assets (median %)	3.04	3.05	3.04	3.02	3.03

<b>Liquidity / Sensitivity</b>	<b>Q4-04</b>	<b>Q4-03</b>	<b>Q4-02</b>	<b>Q4-01</b>	<b>Q4-00</b>
Loans to Assets (median %)	69.1	65.9	65.8	65.2	65.9
Noncore Funding to Assets (median %)	14.9	13.0	12.1	11.4	11.8
Long-term Assets to Assets (median %, call filers)	11.5	12.5	11.1	10.9	10.6
Brokered Deposits (number of institutions)	178	136	135	133	134
Brokered Deposits to Assets (median % for those above)	3.9	3.2	3.3	3.1	3.2

<b>Loan Concentrations (median % of Tier 1 Capital)</b>	<b>Q4-04</b>	<b>Q4-03</b>	<b>Q4-02</b>	<b>Q4-01</b>	<b>Q4-00</b>
Commercial and Industrial	115.0	115.7	119.0	120.9	118.2
Commercial Real Estate	178.8	154.8	138.7	122.5	111.1
Construction & Development	29.5	23.3	17.9	16.8	13.2
Multifamily Residential Real Estate	2.4	1.7	1.7	0.7	0.8
Nonresidential Real Estate	133.4	118.0	105.5	96.5	83.7
Residential Real Estate	163.1	151.7	157.4	156.0	155.1
Consumer	43.4	50.5	57.5	66.1	70.6
Agriculture	93.1	103.6	118.0	119.1	126.3

**BANKING PROFILE**

<b>Largest Deposit Markets</b>	<b>Institutions in Market</b>	<b>Deposits (\$ millions)</b>	<b>Asset Distribution</b>	<b>Institutions</b>
Minneapolis-St. Paul-Bloomington, MN-WI	178	52,380	< \$250 mil.	438 (91.6%)
Fargo, ND-MN	25	3,059	\$250 mil. to \$1 bil.	37 (7.7%)
Duluth, MN-WI	33	2,968	\$1 bil. to \$10 bil.	2 (0.4%)
St. Cloud, MN	34	2,817	> \$10 bil.	1 (0.2%)
Rochester, MN	24	2,198		